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EAST EUROPEAN REGIONAL ECONOMIC WRAPUP

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PREFACE

This is the first of what we hope will be a quarterly series summarizing the current economic situation in Eastern Europe. It was designed with several goals in mind. The report should be:

--useful for the policymaker and non-technical reader needing a quick wrap-up and/or warning of issues likely to be key in the next quarter;

--concise, heavy on graphics, and light on text so the reader can absorb its contents within a short time, while retaining it as a useful desk reference;

--a low level of classification so that security concerns will not overly restrict the reader's ability to use the material;

--published on a timely basis. [redacted] 25X1

In essence this report was designed for you. To keep the effort going, we need feedback on whether it meets your needs. If there are ways that this report can be more responsive, we want to know that, too. [redacted] 25X1

This is a product of the Regional East-West Economics Branch, East European Division, of the Office of European Analysis. The report was prepared by [redacted] with contributions from [redacted] Any comments or questions should be directed to [redacted] Chief, East European Divison, Office of European Analysis, [redacted]

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Economic Growth Slows in 1985

Economic growth in Eastern Europe slowed in 1985 primarily due to stagnant industrial output resulting from harsh winter weather, and also to a sharp fall in agricultural output caused by a drought in the Southern Tier countries. After a relatively strong performance in 1984, the region could not overcome a slow 1985 start caused by unusually cold weather that closed factories, disrupted transport, provoked energy shortages, and harmed winter grain crops in Bulgaria and parts of Romania. The severe drought in Albania, Bulgaria, Romania, and Yugoslavia reduced harvests, agricultural raw materials for industry, and hydroelectric power output. [redacted]

Economic performance also was depressed by the continued inability of some countries to import the Western machinery and raw materials necessary to boost production and exports. The reduction of the region's trade deficit with the USSR in 1985 most likely diverted resources from domestic uses and possibly reduced hard currency earnings of some countries. Key developments in Eastern Europe were the following:

--East Germany showed the strongest performance due primarily to a good harvest and strong growth in industrial production in the second half of the year.

--Hungary's GNP fell because of a decline in farm output and slow growth in industry.

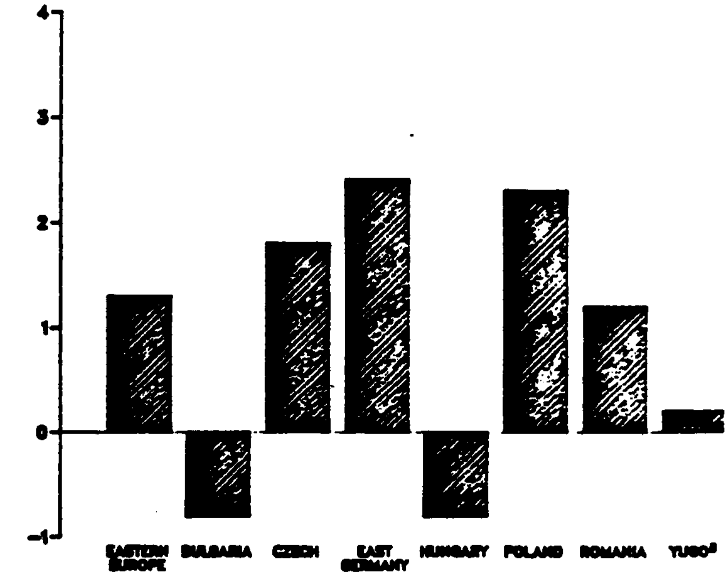
--Yugoslavia's economy showed no growth last year, the result of a sharp fall-off in industrial production and an 8 percent decline in agricultural output. The economy continued to face growing unemployment and accelerating inflation--about 80 percent for 1985.

--Romania stagnated in 1985, in part because it suffered the worst weather: the cold winter and the drought caused energy shortages, disrupted industrial and transportation schedules, killed off crops, and hindered livestock output.

--Poland got off to a bad start due to energy and transport bottlenecks aggravated by the harsh winter, and financial problems continued to limit Western imports needed by industry.

--Czechoslovakia sustained modest growth in 1985, but performance was marred by shortfalls in several key sectors, particularly the machinery industry. [redacted]

Eastern Europe[A]: GNP Growth in 1985



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A Preliminary estimate
B Based on Gross Social Product

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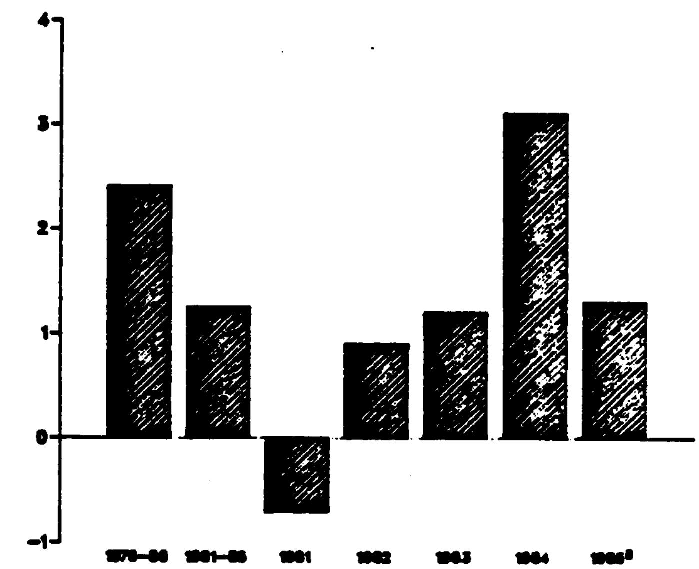
Eastern Europe[A]: Average Five Year & Annual Growth in Gross National Product, 1976 – 1985



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A Excludes Albania
B Preliminary estimate

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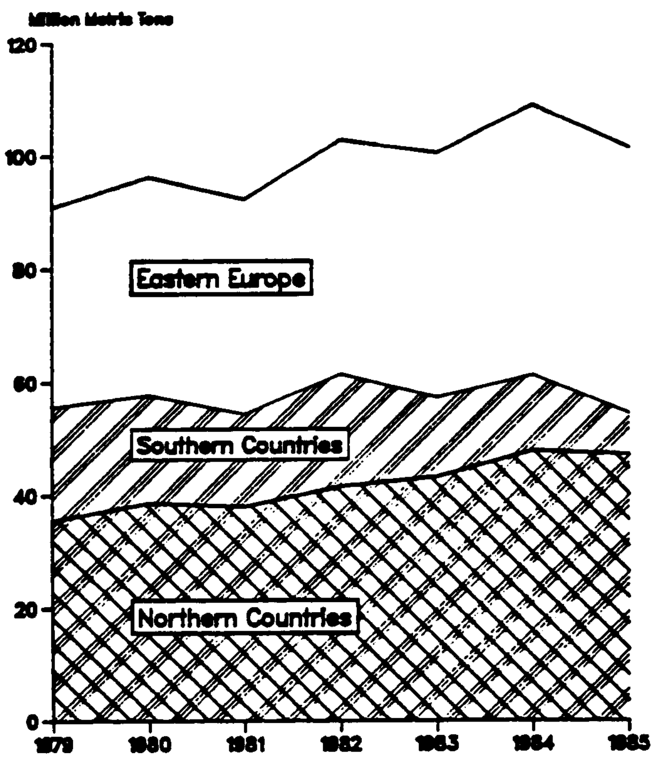
Eastern Europe: Grain Production



[redacted]

Poor Harvest in Southern Tier

A prolonged drought following the harsh winter last year seriously damaged crops in Romania and Bulgaria and to a lesser extent in Yugoslavia. In addition to facing the worst weather in Eastern Europe, Romanian agriculture--hampered by shortages of fertilizers and herbicides and lags in harvesting--produced only about 17 million metric tons of grain, its smallest crop since 1975. Bulgaria's crop of just 7 million tons--also the worst since the mid-1970s--caused it to seek emergency purchases of grain, seed, fertilizers, and livestock. Although Yugoslavia fared somewhat better with a 16 million ton grain harvest, near its recent five-year average, total agricultural output fell some 8 percent below the 1984 level. Agriculture's poor performance further depressed the Southern Tier economies already beset with shortfalls in energy and industry. In contrast, 1984's bumper crop had enabled these countries to free up hard currency for imports of Western raw materials and semi-finished goods badly needed to boost industrial production. [redacted] 25X1

In the Northern Tier countries--Poland, East Germany, and Czechoslovakia--favorable growing conditions, improved supplies of fertilizers and machinery, and greater producer incentives resulted in bumper harvests for the fourth year in a row. The good crops should permit a modest reduction in grain imports and an increase in agricultural exports. [redacted]

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Eastern Europe: Grain Production
(million metric tons)

	1980	1983	1984	1985a
TOTAL	96.3	100.4	108.9	101.3
Southern Countries	57.7	57.2	61.2	54.3
Romania	20.2	18.4a	19.0a	16.6
Bulgaria	7.8	7.7a	8.9a	7.0
Yugoslavia	15.7	17.3	18.0	15.8
Hungary	14.0	13.8	15.3	14.9
Northern Countries	38.6	43.2	47.7	47.0
Poland	18.3	22.1	24.4	23.7
East Germany	9.6	10.1	11.3	11.6b
Czechoslovakia	10.7	11.0	12.0	11.7

a CIA estimate
b Official announcement by the country

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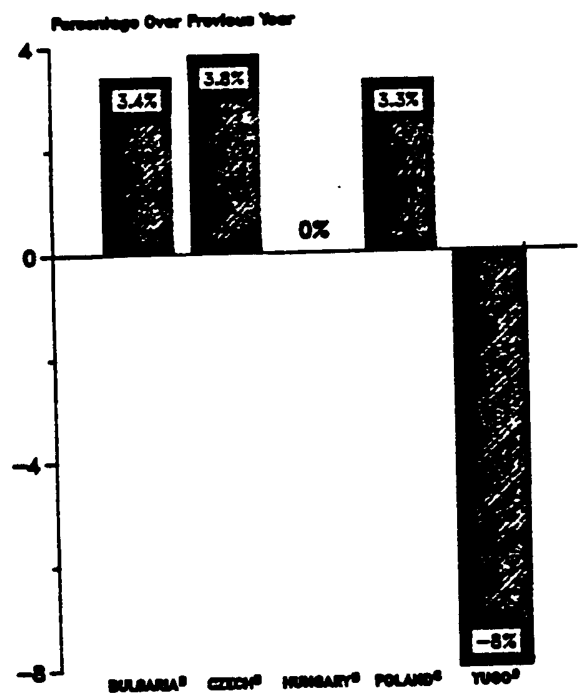
Eastern Europe: Retail Sales[A]



A Constant price data for retail sales are not available for Romania and East Germany
B 9 Month data
C 11 Month data
D 8 Month data

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Consumer Supplies Limited by Harvest and Export Push

The consumer enjoyed only marginal growth at best in market supplies in 1985 due to harvest shortfalls, increased hard currency food exports, and a rise in consumer goods exports to the USSR. Supplies remained the poorest in Romania, where food and consumer goods shortages forced the continued rationing of most staples. Supplies in Yugoslavia were better than in Romania, but retail sales fell due to higher prices and reduced consumer purchasing power. Even in Hungary--usually well-stocked with supplies--the regime admitted that supplies of certain meats, fish, and poultry were less than last year. Prospects for major consumer gains in the Southern Tier remain dim in 1986, and more austerity could occur, especially in Romania.

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Better than average harvests contributed to some rises in the market supplies in Poland and Czechoslovakia. Nonetheless, meat rationing continued in Poland, and supplies of many non-food items did not fulfill consumer demand. Shortages of fruits, vegetables, clothing, and furniture also were acknowledged officially last year in Czechoslovakia. Despite these problems, improvements in consumer welfare in 1986 appear more likely in the Northern than in the Southern countries.

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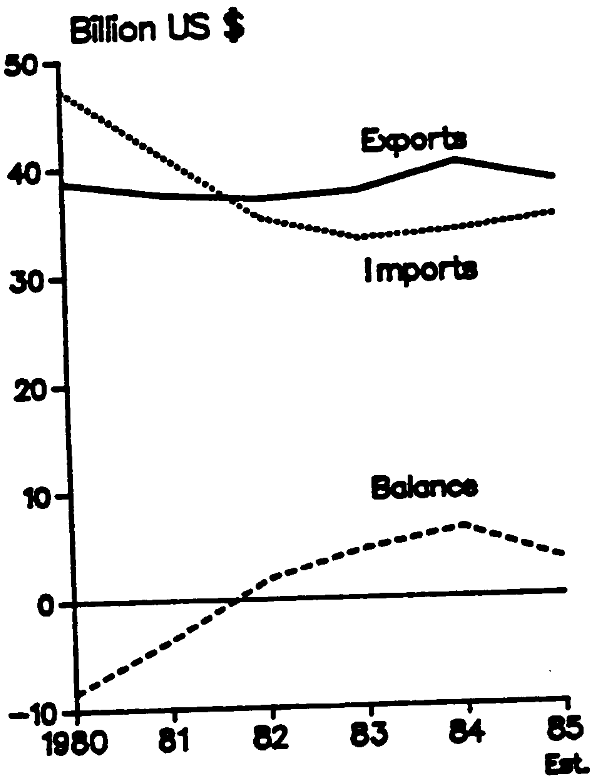
Eastern Europe: Hard Currency Trade



Hard Currency Trade Performance Deteriorates

The region's hard currency trade surplus fell by more than $3 billion, to an estimated $3.3 billion in 1985, reversing the steady improvement of the past several years. Imports grew by roughly 4 percent as the region was forced to significantly boost hard currency energy and grain imports. Only import restrictions on some badly needed industrial materials averted a steeper rise in imports. Exports fell by more than 4 percent as unusually harsh winter weather and shortages of material inputs disrupted industrial production and export schedules.

Key trade developments in the region include the following:

--The severe summer drought coupled with winter reductions in Soviet oil deliveries forced Bulgaria to make heavy hard currency grain and energy purchases at levels that made its trade performance the worst in the region.

--Hungary barely avoided a hard currency trade deficit as prices for its agricultural exports fell and imports surged following relaxation of import controls.

--Harsh winter weather reduced Polish coal exports, gains in machinery exports failed to materialize, and imports rose more than planned, causing Poland's hard currency trade surplus to fall 25 percent short of its $1.5 billion target.

--Romania was unable to make up losses sustained in the first quarter period of cold weather. Trade shortfalls forced Bucharest to return to Western lending markets--Romania's first loans since Ceausescu prohibited all new borrowing in 1983.

--Yugoslavia's claim that the country had "turned the corner" in 1984 and was on a stable success track proved premature. Hard currency exports rose about 3 percent instead of a planned 15 percent, while imports increased by over 10 percent. As a result, the country's convertible trade deficit increased by 50 percent in 1985.

--East Germany claimed a healthy trade surplus in convertible currency in 1985, but we estimate that it has declined from its 1984 level. East Berlin's imports from West Germany outpaced its export growth last year, bringing East Germany to a moderate deficit in intra-German trade.

--Czechoslovakia again boasted a solid trade surplus with nonsocialist countries in 1985. A yearend "spending spree" raised imports above 1984 levels, while exports barely grew.

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Trade Deficit with USSR Shrinks

Eastern Europe responded to Soviet demands for more balanced trade by sharply cutting trade deficits with the USSR last year. Soviet trade data show Eastern Europe--excluding Yugoslavia--running a 900 million ruble deficit with the USSR through three quarters of 1985, compared with a 1.6 billion deficit in the same period of 1984. Unlike in 1984, the region was nearly in balance with the USSR after excluding Poland's persistent trade deficit. The improvement was caused by a reduction in the trade deficits or even the creation of a surplus for most countries. The exceptions were Poland, whose trade deficit with the USSR increased by 200 million rubles, and East Germany, whose surplus with the Soviets fell by the same amount.

Protocols concluded in the final months of 1985 between the USSR and its East European allies imply an average annual growth rate in Soviet-East European trade through 1990 of only 5 percent--the slowest growth in either planned or actual trade in the past 15 years. East European exports are likely to grow faster than the USSR's, reversing the trade imbalances of the past decade. Moreover, Moscow's economic relations with its East European allies could well shift even more dramatically if hard currency or oil production difficulties cause a drop in Soviet oil exports below plan.

Eastern Europe: Trade with USSR
January-September 1984 and 1985
(million rubles)

	Exports		Imports		Balance	
	1984	1985	1984	1985	1984	1985
TOTAL	22482	23980	24094	24882	-1612	-902
Bulgaria	4122	4425	4661	4788	-539	-363
Czechoslovakia	4422	4806	4948	5002	-526	-195
East Germany	5577	5619	5385	5619	191	0
Hungary	3178	3513	3298	3318	-120	195
Poland	3843	3960	4450	4804	-606	-845
Romania	1340	1657	1352	1351	-12	306

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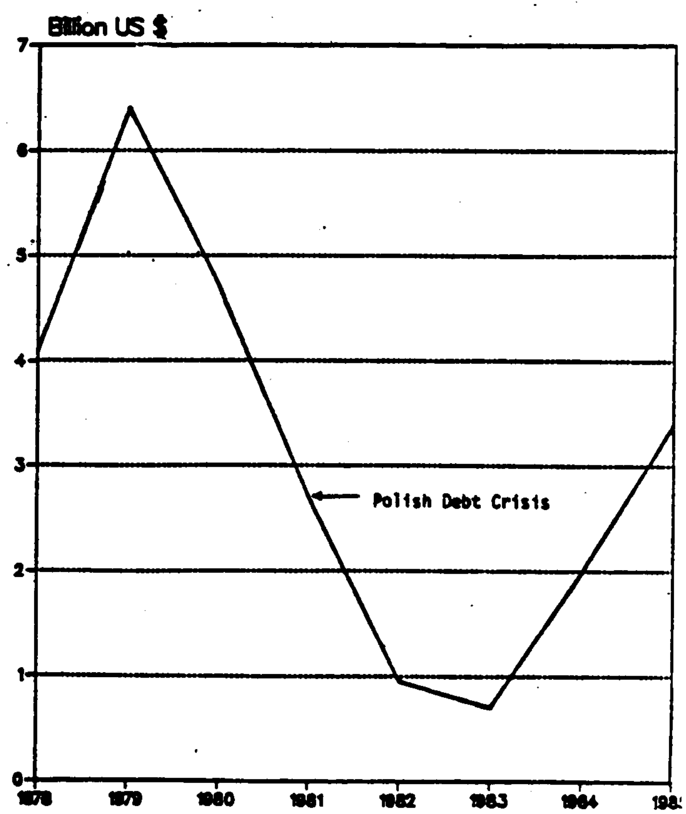
Countries on Borrowing Binge

Eastern Europe secured $3.4 billion in syndicated loans from Western banks in 1985--up 70 percent from 1984. The growth of loans reflected poor lending opportunities elsewhere more than enthusiasm over the region's economic performance. East Germany and Hungary, each of which acquired over $1 billion, were preferred clients, as were conservative borrowers Bulgaria and Czechoslovakia. Romania's creditor banks, on the other hand, lent reluctantly to help Bucharest cover its debt payments and keep its rescheduling agreements from unravelling. Poland and Yugoslavia, which face more years of debt reschedulings, remained blackballed from the syndicated loan market.

Borrowers benefitted from the favorable lending environment by seeking new loans with lower interest rates and longer maturities than they obtained in 1982-83. These new funds were used to replace short-term debt accumulated in 1982-83, boost reserves, and close hard currency gaps opened by deteriorating trade balances last year. Most countries will need new loans this year, and banks seem willing to grant them to the most creditworthy.

Amount of Syndicated Loans to Eastern Europe



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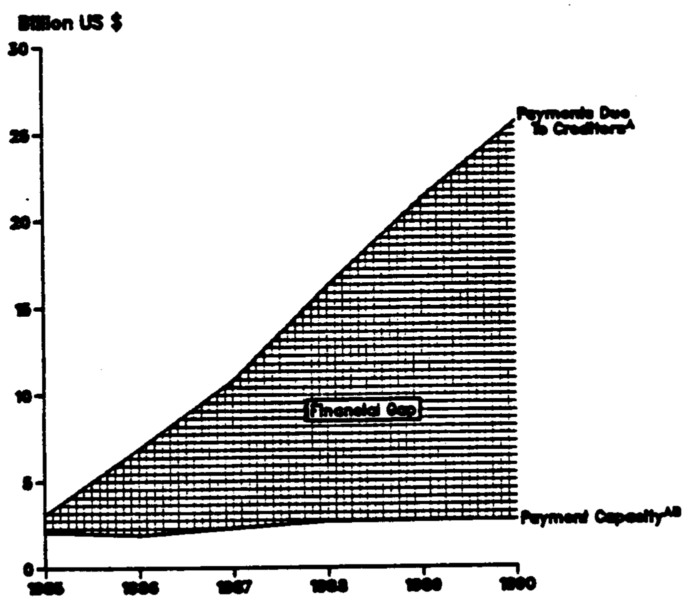
Featured Country: Polish Financial Problems Mount

The financial situation deteriorated in 1985, as Poland failed to meet its debt payments despite more than $13 billion worth of reschedulings by government creditors. We estimate that Poland was able to pay governments, banks, and other creditors only $2 billion of the $3 billion on the books for 1985. This financing gap was rolled over into this year for further rescheduling. A shortfall in export earnings and a lack of new hard currency credits accounted for the financial gap. [redacted] 25X1

Warsaw's financial situation will become more pressing in the next five years. Increasing amounts of principal will fall due on previous rescheduling agreements, and interest costs will remain high. Warsaw seems unlikely to take the measures needed to improve export performance, even if it eventually enters the IMF and negotiates an adjustment program with the Fund. Without better trade performance, Poland is unlikely to get much new Western credit, and funds from the IMF and World Bank will be inadequate to close the payments gap. We project that the gap will increase from almost $5 billion in 1986 to $23 billion in 1990, and the total debt will climb to $38 billion. Western private and official creditors face the prospects of rescheduling already rescheduled debt into the late 1990s and disputes over sharing Warsaw's limited payments capacity. [redacted] 25X1

Poland's Increasing Financial Gap



A CIA Estimates

B Assumes a 4 percent annual growth in exports and imports and credits from the IMF and World Bank based on the experience of other borrowers. Terms for the repayment of new borrowings were assumed to be a 5 year grace and a 5 year principal repayment period.

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A Look Ahead

Eastern Europe's economic plans for 1986--the first year of the new five-year plans--focus on the common problems of technological stagnation, energy dependence, and uncompetitive exports. Most of the new plans call for modest growth, but Romania and Albania have set wildly unrealistic growth targets. Planners are seeking to reverse the reductions in real investment made in the early 1980s to adjust to the region's foreign trade and financial problems. Investment priorities are machine tools, high technologies, and energy conservation programs. The lower growth targets for basic industries than for industries producing finished products suggest more efficient use of raw materials will be needed to avoid new bottlenecks. The plans also call for improved trade performances in both CEMA and hard currency markets by modernizing export industries. Even with good luck on weather and exports, however, these countries will have to score unusually large productivity gains to meet their plan goals. 25X1

Eastern Europe: 1986 Annual Plan Targets

(Goals are expressed as percentage growth over actual output for 1985.)

	National Income Produced*	Industry	Agriculture
Albania	10.6	7.3	17.0
Bulgaria	4.0	4.5	7.4
Czechoslovakia	3.5	2.9	2.5
East Germany	4.4	8.5	0.3
Hungary	2.3-2.7	2.0-2.5	3.0-3.5
Poland	3.1-3.4	3.2-3.6	0.0-0.3
Romania	10.0-12.0	12.0-15.0	10.0-12.0
Yugoslavia	3.0	3.0	8.0

*Goals for national income are not comparable to GNP growth rates mentioned earlier because Communist countries do not use Western GNP accounting methods for planning.

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What topics would you like to see analyzed in future issues?

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Thank you for your assistance. Please return any comments to:

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